

**75,700,000**



**CANADIAN OIL SANDS TRUST**

1997 annual report

## CORPORATE PROFILE

Canadian Oil Sands Trust (the Trust) was established in June, 1996 and through its subsidiary Canadian Oil Sands Investments Inc., (Canadian Oil Sands) holds a 10 percent interest in the Syncrude Project (Syncrude), the world's largest oil sands mining project. Canadian Oil Sands is administered by PanCanadian Petroleum Limited and management of the Trust is overseen by a Board of Directors. The Trust's 27 million units, including the issue of 4 million units in February of 1998, are owned by investors in Canada and internationally, and are traded on The Toronto Stock Exchange under the symbol CO.UN. The Trust pays quarterly distributions to its unitholders.

Syncrude is a joint venture formed to produce synthetic crude oil from oil sands deposits located approximately 40 kilometres north of Fort McMurray, Alberta. The long-life assets are operated and managed by Syncrude Canada Ltd., a company which is owned by the 10 participants in the Syncrude project in the same proportions as their interest in the joint venture.

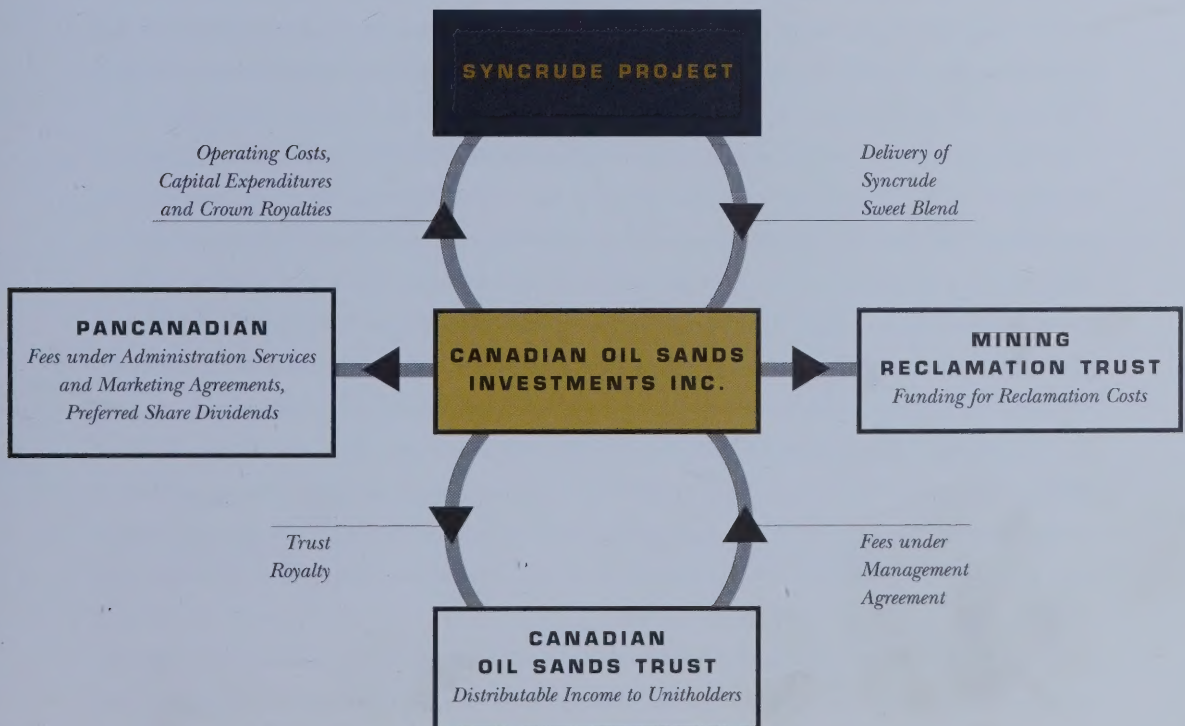
**75,700,000**

*During 1997, Syncrude produced 75,700,000 barrels of Syncrude Sweet Blend crude which was another annual production record.*

1	<i>Corporate Highlights</i>
2	<i>Report to the Unitholders</i>
4	<i>Performance of Canadian Oil Sands Trust Units</i>
5	<i>The Market for Syncrude Sweet Blend</i>
6	<i>Syncrude's Reserve Base</i>
7	<i>North American Oil Reserve Life</i>
8	<i>The Syncrude Project</i>
12	<i>Management's Discussion &amp; Analysis</i>
16	<i>Management's Report</i>
16	<i>Auditors' Report</i>
17	<i>Consolidated Financial Statements</i>
20	<i>Notes to Consolidated Financial Statements</i>
24	<i>Statistical Review</i>
IBC	<i>Corporate Information</i>

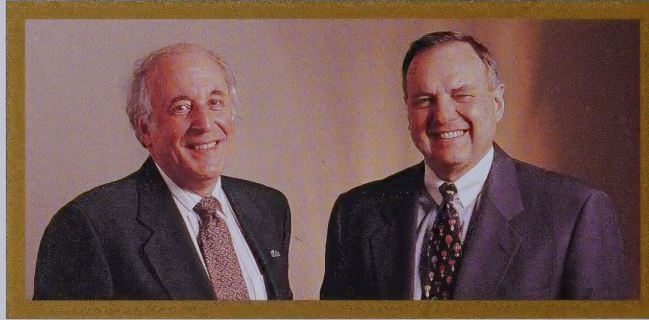
## CORPORATE HIGHLIGHTS

	Year Ended December 31, 1997	June 20 to December 31, 1996
Net income ( <i>thousands of dollars</i> )	<b>51,247</b>	20,503
Per Trust Unit	<b>\$ 2.23</b>	\$ 0.89
Funds from operations ( <i>thousands of dollars</i> )	<b>78,049</b>	33,736
Per Trust Unit	<b>\$ 3.39</b>	\$ 1.47
Distribution to Unitholders ( <i>thousands of dollars</i> )	<b>41,400</b>	21,390
Per Trust Unit	<b>\$ 1.80</b>	\$ 0.93
Daily average production ( <i>barrels</i> )		
Syncrude Sweet Blend	<b>20,647</b>	21,259
Average selling price ( <i>dollars per barrel</i> )		
Realization at plant gate	<b>\$ 27.82</b>	\$ 30.92
Hedging		
Oil Price	<b>(0.33)</b>	(2.79)
Currency	<b>0.36</b>	0.47
	<b>\$ 27.85</b>	\$ 28.60



## TO OUR UNITHOLDERS

G. A. Montemurro  
*Chief Executive Officer*



C. E. (Chuck) Shultz  
*Chairman of the Board*

During 1997, our first full year of existence, Canadian Oil Sands Trust experienced continued appreciation in the trading value of its units, completed the restructuring of its debt, increased its lines of credit by \$200 million and received regulatory approval for the development of the Aurora Mine. In February of 1998, to ensure funding will be available for the expansion, the Trust bolstered its available funds with the issuance of 4 million Trust Units for net proceeds of \$92 million. With the increase in its lines of credit and the proceeds from the equity issue, management believes that Canadian Oil Sands has the financial capability to fully participate in the \$6 billion "Syncrude 21" expansion which will double production by 2007 and significantly reduce operating costs.

Cash distributions to Unitholders of \$1.80 per unit in respect of the 1997 operations were in line with our expectations, and when coupled with the \$6.50 appreciation in the Trust Unit value, provided Unitholders with a total return of approximately 40 percent for the year. At the end of 1997, the Trust Units were trading at \$27.00 compared to \$20.50 at the end of 1996.

Syncrude achieved another annual production record with 75.7 million barrels of Syncrude Sweet Blend reported in 1997, the 16th record in 19 years of operations. The record setting production is the result of an improving bitumen extraction recovery from the oil sands, an increase in the rate of bitumen fed to the cokers and an improvement in the yield of Syncrude Sweet Blend crude oil from the bitumen. The unit operating cost of \$13.77 per barrel was very close to the 1995 and 1996 unit cost despite some significant one time expenses related to the commissioning of the first train of the North Mine hydro-transport system, a new Hydrogen Recovery Unit and the extension to one of the cokers.

On May 20, 1997, Canadian Oil Sands issued US\$70 million of Senior Notes with an interest rate of 7.625 percent and a maturity date of May 15, 2007. The fixed rate interest obligation was swapped back to a lower Canadian floating rate. The net proceeds of the offering were used to repay the existing \$95 million bank loan which had some restrictive covenants and may have required principal repayments commencing in 1999.

On October 24, 1997, the Alberta Energy and Utilities Board approved Syncrude's application for the development of the Aurora Mine. The Aurora Mine has recoverable reserves estimated at 3.6 billion

barrels of Syncrude Sweet Blend and will be developed in stages to provide lower cost bitumen for Syncrude's future growth.

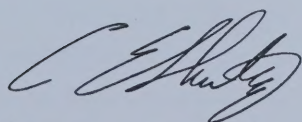
On November 24, 1997, Syncrude announced its plan to seek regulatory approval to further increase the capacity of its Mildred Lake Upgrading Facility from 110 million barrels per year to 175 million barrels per year. These plans complement Syncrude's development of the Aurora Mine and bring Syncrude's capital spending plans over the next ten years to approximately \$6 billion. Syncrude's leases contain sufficient bitumen to support the anticipated level of production for at least 40 years.

The expansion of Syncrude will result in the doubling of production which, for Canadian Oil Sands, is the equivalent of acquiring another 10 percent interest in Syncrude. Canadian Oil Sands intends to finance the expansion of Syncrude using a combination of external financing and internally generated cash flow rather than relying exclusively on internally generated cash flow. Although still subject to fluctuations in commodity prices, this approach to financing should ensure future cash distributions provide a stable stream of income, as well as retain a significant growth component for the Trust Units.

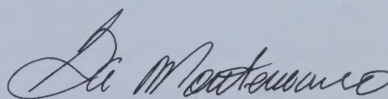
Oil prices have been volatile in 1997 with the price of West Texas Intermediate crude oil averaging US\$22.77 in the first quarter and dropping to a US\$19.94 average for the fourth quarter. Canadian Oil Sands has been somewhat sheltered from the fourth quarter prices by its oil price put options which provided a floor price of US\$21.00 per barrel on 10,000 barrels per day for much of the fourth quarter. There is also a US\$21.00 floor in place for 7,000 barrels per day for the first quarter of 1998.

Looking forward to 1998 and beyond, Syncrude has set aggressive targets for production levels and operating cost reductions. Syncrude anticipates a steady growth in production from 80 million barrels in 1998 to 100 million barrels by 2002 with a significant jump in production in 2003 and 2006 when annual production ramps up to 125 million barrels and 150 million barrels, respectively. Although the capital requirements of the Syncrude expansion are considerable, the expansion is economic assuming reasonable oil price expectations and it will increase future cash distributions from the Canadian Oil Sands Trust as well as enhance the value of Trust Units.

And finally, we would like to thank the personnel at Syncrude who provide the skill and dedication required to achieve our operating results. Our colleagues at PanCanadian continue to provide us with valuable management expertise and knowledge for which we are also appreciative.



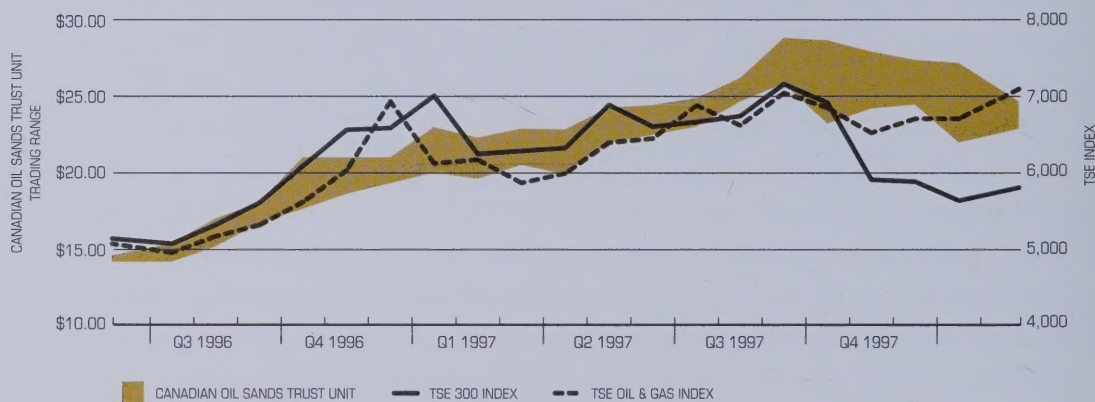
C.E. (Chuck) Shultz,  
Chairman of the Board  
February 19, 1998



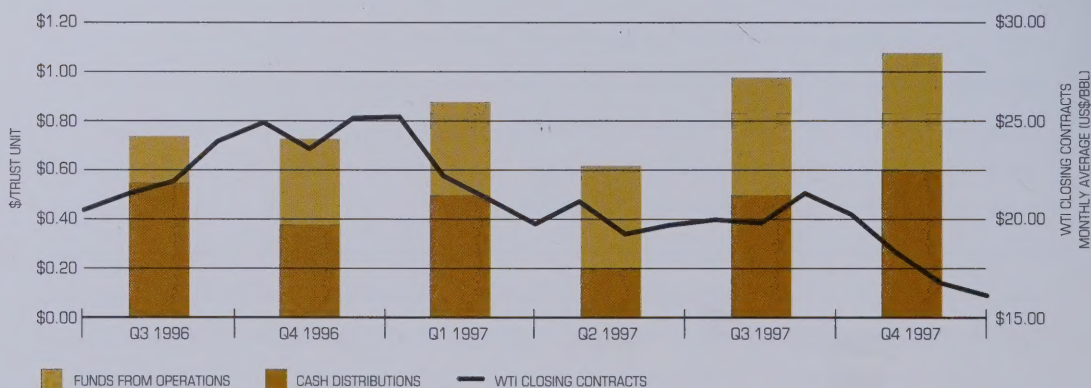
Monte Montemurro,  
Chief Executive Officer

## PERFORMANCE OF CANADIAN OIL SANDS TRUST UNITS

The Trust Units of Canadian Oil Sands Trust trade on the Toronto Stock Exchange. The following chart compares the Trust Unit's price range as traded on the Toronto Stock Exchange to the value of the TSE 300 Index and the TSE Oil and Gas Index since June 20, 1996, the first day of trading for the Trust Units:



The amount of Cash Distributions to the Unitholders is dependent on the quantity of oil produced, prices received (including hedging receipts and payments), capital expenditures, operating and administrative expenses and debt charges. The chart below compares the quarterly per unit amounts of Funds From Operations and Cash Distributions for the six quarters of the Trust's existence to the average price of West Texas Intermediate crude oil contracts:



Canadian Oil Sands Trust has been able to designate its Cash Distributions in 1997 and 1996 as a return of capital for income tax purposes. It is anticipated that the Trust will continue to categorize its Cash Distributions as a return of capital for at least the next four years. Cash Distributions categorized as a return of capital reduce the Unitholders' Adjusted Cost Base in the Trust Units.

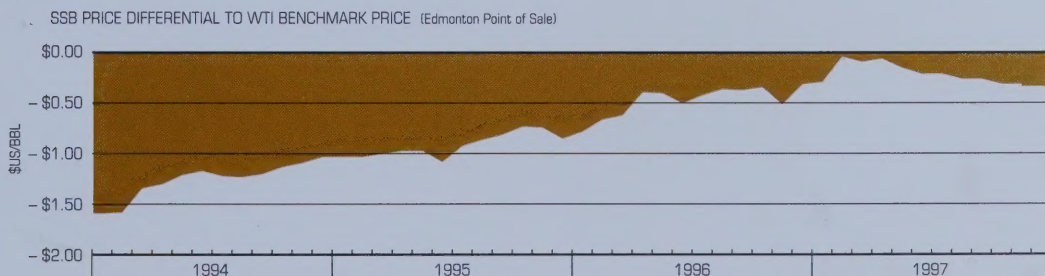
## THE MARKET FOR SYNCRUDE SWEET BLEND

The Syncrude Project produces a light, sweet crude oil known as Syncrude Sweet Blend (SSB) which has a 31 degree API gravity and a low sulphur content. It is comparable to conventional light sweet crudes except that SSB has no residual bottom ends. Refineries often replace conventional sweet crude feedstock with SSB but more typically SSB is blended with other crudes to balance the refinery's product mix and manage sulphur emissions. SSB often constitutes 7 percent to 20 percent of a refiner's feedstock.

In the near term, Canadian Oil Sands anticipates that crude oil producers will continue to lower operating costs and that capacity increases in OPEC countries (especially Venezuela), the North Sea, and the Gulf of Mexico will result in crude oil supply pressures in North America. The US oil markets are experiencing a decline in their domestic supply of light sweet crudes while the supply of heavy/sour crudes is anticipated to continue to grow, especially from Canada, Mexico and Venezuela. Canadian Oil Sands anticipates that SSB will continue to be a premium product in high demand by US refiners for blending with the generally heavier slate of crudes available in the market.

In addition, the "Line 9 Reversal" in 1998 will provide Canadian refineries west of Quebec with access to foreign supplies of light crudes. This will shift a portion of Western Canada's sweet crude production to the mid-western US refiners which could negatively impact the price of Western Canadian crude oil.

The SSB crude is priced relative to Western Canadian light sweet crudes which follow the trends of the West Texas Intermediate benchmark price (WTI). Over the past four years, the price received for SSB delivered at Edmonton has improved from the WTI benchmark price minus US\$1.60 to WTI minus US\$0.20. This has been attributed to the supply of conventional light sweet crudes becoming tighter and the US refiners' desire to purchase SSB rather than other crudes. The following summarizes the net price differential between SSB and the WTI benchmark price for Edmonton deliveries over the past four years:



During 1997, Canadian Oil Sands sold approximately 50 percent of its share of Syncrude production to Edmonton-based refineries, 35 percent to mid-western United States refiners and the remaining 15 percent split between Eastern Canadian refiners and those on Canada's West Coast. This geographic distribution of its customer base provides Canadian Oil Sands with a competitive marketplace for its premium product as well as diversifies the business risks associated with being heavily dependent on one or two significant customers.

## SYNCRUDE'S RESERVE BASE

Since 1978, Syncrude has operated from its Mildred Lake location on Leases 17 and 22. The Mildred Lake operations include the Base Mine, East Mine and West Mine which use draglines, bucket-wheel reclaimers and conveyor belt systems to move the oil sand to the processing facilities. In September of 1997, the first train of the North Mine, also located on Lease 17, was brought on stream using a truck and shovel fleet with a daily processing capacity of 140,000 tonnes of oil sand. In October of 1997, Syncrude received approval from the Alberta Energy and Utilities Board (the AEUB) to develop the Aurora North Mine on Leases 10, 12 and 34. The AEUB is also prepared to approve the Aurora South Mine on Lease 31, subject to a satisfactory resolution on the location of the field extraction plant and tailings pond. Commencing production in 2000, the Aurora North Mine will be developed in stages to provide lower cost bitumen for Syncrude's future growth. The Aurora South Mine is an integral component of Syncrude's long term development plan and is currently planned to commence production in 2008.

The proven reserves of Syncrude Sweet Blend attributed to Canadian Oil Sands' 10 percent share of the Syncrude Project have been evaluated by Syncrude's Mine Development engineers to be 223.8 million barrels at December 31, 1997, on a before Crown Royalty basis. These reserves reflect production from leases 17 and 22 at a gross production rate for Syncrude of approximately 220,000 barrels per day until December 31, 2025, based on the current operating approval for the Mildred Lake processing facilities.

In 1998, the Syncrude owners are expected to approve the development of the Aurora Mine, and in 1999, will consider the approval of the expansion of the Mildred Lake upgrading capacity from 110 million barrels to 175 million barrels. The expansion of the Mildred Lake upgrading capacity has yet to receive regulatory approval from the AEUB. With owner and regulatory approvals, the reserves of the Syncrude Project will be enhanced with the addition of approximately 3.6 billion barrels of recoverable SSB attributed to the Aurora Mine development and the increase in upgrading capacity.

Reserve Life Index is an industry benchmark to estimate the remaining productive life of reserves as determined by dividing the year end proven reserves by the current annual production rate. At the end of 1997, the Syncrude Project has a Reserve Life Index of 29.5 years based on reserves of 2,238 million barrels of SSB and an annual productive capacity of 75.7 million barrels. Compared to the Reserve Life Index of Canada (9.4 years) and the United States (9.7 years), the Syncrude Project's current Reserve Life Index is approximately 3 times the North American conventional industry's Reserve Life Index. The addition of 3.6 billion barrels to Syncrude's reserve base, along with a doubling of its productive capacity, would bring its Reserve Life Index to approximately 40 years.

# NORTH AMERICAN OIL RESERVE LIFE\*

Syncrude

**29.5** YEARS

Canada

**9.4** YEARS

U.S.A.

**9.7** YEARS

The Syncrude Mines

AURORA  
NORTH

AURORA  
SOUTH

MILDRED  
LAKE

## THE SYNCRUDE PROJECT



The Syncrude Project was established to develop a supply of petroleum from the Athabasca oil sands and has become Canada's largest single source of oil as well as the largest operator in the Alberta oil sands. In 1997, Syncrude produced 75.7 million barrels of Syncrude Sweet Blend (SSB), approximately 12 percent of Canada's annual oil requirements. Canadian Oil Sands Trust, through its wholly-owned subsidiary Canadian Oil Sands Investments Inc., owns a 10 percent interest in the Syncrude Project.

### AN OVERVIEW OF BITUMEN MINING AND PROCESSING

Syncrude mines oil sand from a surface mine, extracts the bitumen from the sand and then upgrades the bitumen into crude oil by coking, hydroprocessing, hydrotreating and blending. The final product, Syncrude Sweet Blend, is pipelined to refineries in Edmonton, the midwest United States, Eastern Canada and Canada's West Coast.

Since 1978, Syncrude has mined the oil sand using draglines, bucketwheel reclaimers and a system of conveyor belts to move the material to the extraction facilities. Syncrude has progressively introduced new technologies in its mining operations such as truck and shovel operations for base mining and the hydrotransport system to move the oil sand from the mine to the extraction facilities. The North Mine, which commenced operations in September 1997, uses a truck and shovel operation with a hydrotransport system exclusively. This new technology will provide productivity gains as well as reduce the cost of mining.

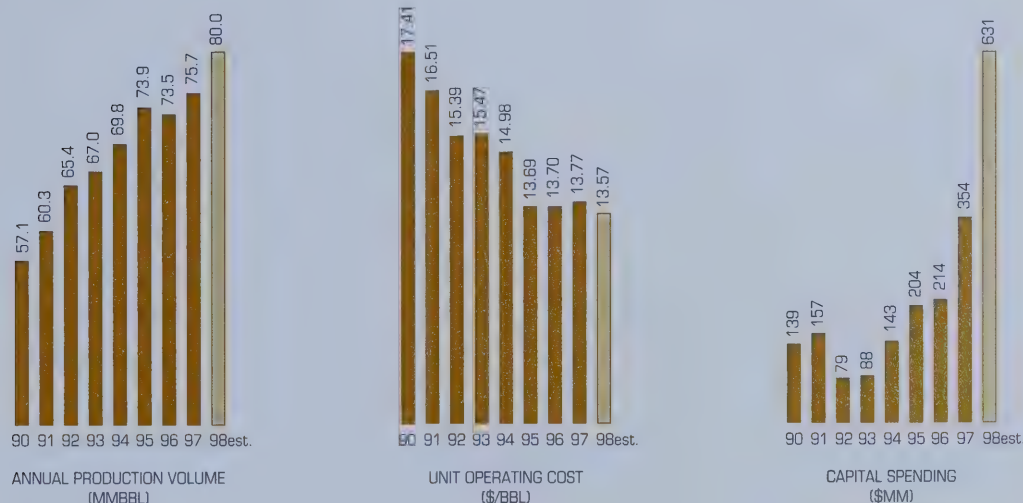
The Aurora Mine will use similar technology with the oil sand hydrotransported to a field extraction facility where a low temperature/low energy process will be used to extract bitumen from the oil sand. The resulting bitumen froth will then be pipelined over 30 kilometers to the central upgrading facilities at Mildred Lake. These technologies enable the mining of bitumen at remote locations with further processing at centralized upgrading facilities at a reduced cost and improved productivity.

At the extraction facilities, the oil sand is fed into large rotating drums called tumblers and mixed with hot water, steam and caustic soda. The slurry from the tumblers is screened to remove large lumps,

mixed with the bitumen from the hydrotransport system and fed into separation vessels where bitumen floats to the surface as a froth. The bitumen is diluted with naphtha and then fed into centrifuges which further separate liquids and solids. Finally, the naphtha is removed and returned to the extraction plant for reuse, leaving only clean bitumen, the feedstock for the upgrading facilities.

The upgrading process converts the bitumen from a viscous, tar-like oil to a straw coloured liquid called Syncrude Sweet Blend (SSB). In Primary Upgrading, cokers break the bitumen molecules into the lighter products, primarily naphtha and gas oils, and coke, which is stockpiled for potential future use. The lighter products, which are high in sulphur, nitrogen and other impurities, are split into raw naphtha, light gas oil and heavy gas oil as feed for the Secondary Upgrading units. Hydrotreaters are used to remove sulphur, nitrogen and other impurities prior to re-blending the products to form a light sweet crude oil, SSB. The average yield of bitumen to SSB in 1997 was approximately 84 percent.

## REVIEW OF 1997 OPERATIONS



## Syncrude Sets Production Records

Syncrude's 1997 production of 75.7 million barrels of SSB is an increase of three percent over the 73.5 million barrels produced in 1996 and established a new annual production record surpassing the previous record of 73.9 million barrels in 1995. Syncrude has set annual production records in 16 of its 19 years of operation. On September 28, 1997, Syncrude set a daily production record of 256,200 barrels of SSB surpassing the 247,600 barrel record established in 1996; a monthly production record of 7.3 million barrels was set in August; and, the 1997 fourth quarter production of 21.6 million barrels was also a new record. Syncrude continues to increase the operating capacity of its facilities with modifications and improved operating "know how" by its workforce. The commissioning of the first train of the North Mine

in September of 1997 has ensured the feedstock required to maintain a steady flow of bitumen to the cokers.

### Operating Costs Unchanged at \$13.77 per Barrel

Syncrude's operating costs for 1997 totaled \$1,043 million (\$13.77 per bbl) compared to \$1,007 million (\$13.70 per bbl) in 1996. The unit costs in 1997 are relatively unchanged from 1996 primarily due to the three percent increase in total expenditures being offset by a 2.2 million barrel increase in production in 1997. Syncrude's operating costs are higher than anticipated due to the high prices for purchased energy (electrical and natural gas), maintenance expenditures in the Extraction facility and engineering costs incurred to enable the acceleration of the Syncrude 21 project.

Many of Syncrude's operating costs are fixed in nature with salaries, employee benefits, contract labour and consultants comprising approximately 60 percent of Syncrude's cost structure. The following charts present Syncrude's cost structure by its significant components and by area of operating responsibility:



### Capital Expenditures Include \$229 million for Expansion Projects

Capital expenditures totaled \$354 million for 1997 including \$229 million in respect of strategic growth initiatives and \$125 million in respect of capital to sustain Syncrude's existing operations. The more significant strategic growth initiatives were the development of the North Mine, accounting for \$131 million of capital expenditures, and the completion of the De-Bottleneck I initiative involving capital expenditures of \$49 million.

Capital expenditures to sustain Syncrude's existing operations totaled \$125 million in 1997 with the replacement of 96 percent of the tailings pipe being the most significant. Expenditures on sustaining operations in 1996 and 1995 were \$92 million and \$152 million, respectively.

## THE EXPANSION OF SYNCRUDE

On November 21, 1997, Syncrude announced plans for a proposed \$3 billion expansion of its Mildred Lake Upgrading Facility which is expected to increase productive capacity to 175 million barrels per year. The final approval by the Syncrude Owners is subject to market factors and detailed engineering as well as the timely receipt of regulatory approvals. This expansion will bring the total expenditures for initiatives announced under the "Syncrude 21" banner to approximately \$6 billion. A decrease in Syncrude's operating costs, as expressed in constant "1997 dollars", is forecast, from \$13.77 per barrel in 1997 to under \$10.00 per barrel by 2007. The expansion of the upgrading facilities will increase production of an even better quality, low sulphur crude oil which will be feedstock for such end uses as diesel and jet fuel. Syncrude's schedule anticipates receiving regulatory approval by late 1998. When approved, the equipment for the upgrader expansion will be ordered and construction will begin in 1999. Partial production should commence in 2002 with full capacity production expected by 2007.

Syncrude enjoys a competitive advantage in the development of Alberta's oil sands due to its existing infrastructure and its 20 year history of safe reliable operations from which production has grown while unit operating costs have decreased. Syncrude also has a significant resource base of over 12 billion barrels of bitumen in place. With this track record of operating proficiency, the Syncrude Owners expect that the expansion of Syncrude will progress as planned.

In the event of unexpected adverse economic conditions, the "Syncrude 21" plan includes "off ramps" which enable the delay or termination of the expansion. Each stage of the expansion plan involves an increase in mining capacity coupled with either a de-bottleneck improvement or an expansion of the upgrader facilities. As planned, each stage of the expansion should add value to the Syncrude project.

## ENVIRONMENT AND SAFETY PERFORMANCE

Since its inception, Syncrude has been a committed industrial leader in environmental protection. There have been no material environmental incidents in the history of Syncrude. Syncrude's 1997 environmental performance continued to make progress towards achieving the following goals:

- To reduce SO<sub>2</sub> emissions per barrel by 31 percent between 1990 and 2000
- To reduce CO<sub>2</sub> emissions per barrel by 32 percent between 1988 and 2002
- To manage tailings materials and reclaim disturbed land to a stable, biologically self-sustaining state
- To ensure its operations do not permanently affect surface or ground water systems

Syncrude's 1997 safety record earned the 1997 Major Industrial Accident Council of Canada Award for Excellence in Prevention, Preparedness and Response Programs and placed Syncrude in the top quartile of the industry in respect of Lost Time Frequency.

# MANAGEMENT'S DISCUSSION & ANALYSIS

This discussion and analysis should be read in conjunction with the Consolidated Financial Statements and related Auditors' Report dated January 23, 1998. The Consolidated Financial Statements can be found on pages 17 to 23 of this Annual Report. Information provided with respect to future years is Canadian Oil Sands' best estimate of future events. Certain statements included in the section "Outlook for 1998" regarding Cash Distributions, production targets, unit operating cost and planned capital expenditures are forward looking and are based upon assumptions and anticipated results that are subject to uncertainties. Actual results may vary significantly from those anticipated due to many factors including crude oil prices, the Canadian/US currency exchange rate, industry conditions, the availability and prices of goods and services, as well as government regulations and operating risks.

## NET INCOME

Net income for the year ended December 31, 1997 totaled \$51.2 million (\$2.23 per unit) compared to \$20.5 (\$0.89 per unit) for the six month and 11 day period ended December 31, 1996. This improvement was primarily the result of a full year of operations in 1997 compared to approximately six months in 1996 and the substantially reduced Crown Royalties in 1997 due to the 43 percent royalty credit on capital expenditures in 1997.

## PRODUCTION

Canadian Oil Sands' production in 1997 totaled 7.6 million barrels of Syncrude Sweet Blend (SSB) compared to 4.1 million barrels in 1996. Canadian Oil Sands' daily average production rate of 23,000 in the fourth quarter of 1997 represents a 10 percent increase over its daily average production of 20,877 in the fourth quarter of 1996. This increase was the result of an improving bitumen extraction recovery rate and an improvement in the yield of SSB from bitumen. Production is reported on a before Crown Royalty basis.

## REVENUES

Canadian Oil Sands' revenues were \$210.5 million for the year ended December 31, 1997 compared to \$118.7 million for the six month and 11 day period ended December 31, 1996. The price of West Texas Intermediate crude oil averaged US\$20.61 during 1997 compared to US\$22.37 for the period in 1996. Excluding the effects of hedging, Canadian Oil Sands received an average plant gate price of \$27.82 per barrel for SSB in 1997 and \$30.92 per barrel in 1996, before the deduction of the \$0.05 marketing fee paid to Pan Canadian Petroleum Limited. Including the effects of both commodity and currency hedging, the average plant gate price for 1997 was \$27.85 per barrel and \$28.60 in 1996. The settlement of currency hedging contracts added \$2.7 million to revenues in 1997 compared to \$2.0 million in 1996 while the losses from commodity hedging totaled \$2.5 million in 1997 and \$11.6 million in 1996.

## OPERATING COSTS

Operating costs, including Syncrude's administrative costs, for the year ended December 31, 1997 totaled \$103.8 million or \$13.77 per barrel compared to \$12.27 per barrel for the partial year in 1996. See the discussion of Operating Costs in Syncrude's Review of 1997 Operations on page 10 of this Annual Report.

## CROWN ROYALTIES

Crown Royalties for the year ended December 31, 1997 totaled \$20.2 million (\$2.68 per barrel) compared to \$29.5 million (\$7.11 per barrel) in 1996. The \$4.43 reduction in the per unit charge for Crown Royalties in 1997 reflects the introduction of the 43 percent royalty credit on \$35.4 million of capital expenditures effective January 1, 1997. See note 11 to the Consolidated Financial Statements for a detailed description of the Crown Royalty calculation.

## CAPITAL EXPENDITURES

Capital Expenditures for the year ended December 31, 1997 totaled \$35.4 million compared to \$14.2 million for the 6 month and 11 day period in 1996. Sustaining expenditures totaled \$12.5 million while expansion expenditures, those relating to increasing production from Syncrude, totaled \$22.9 million. See the discussion of Capital Expenditures in Syncrude's Review of 1997 Operations on page 10 of this Annual Report.

## MINING RECLAMATION TRUST

The Mining Reclamation Trust was established for the purpose of funding Canadian Oil Sands' share of environmental reclamation obligations of the Syncrude Project. Subject to the funding exceeding the anticipated reclamation costs, Canadian Oil Sands is obligated to pay \$0.10 per barrel for production prior to 2001 and \$0.12 per barrel for production subsequent to 2000. Canadian Oil Sands contributed \$0.8 million in 1997 and \$0.4 million in 1996 to the Mining Reclamation Trust.

## ADMINISTRATION COSTS

Canadian Oil Sands' administrative costs for the year ended December 31, 1997 totaled \$3.3 million (or \$0.44 per barrel) compared to \$1.5 million (\$0.36 per barrel) for the period from June 20, 1996 to December 31, 1996. Included in administration costs are fees paid to PanCanadian Petroleum Limited totaling \$2.4 million in 1997 and \$1.1 million for the period in 1996 in respect of administration and support services. This fee is calculated as 2.75 percent of Canadian Oil Sands' revenues less operating costs and Crown Royalty payments. In addition, the Trust incurred \$451,000 of expenses in 1997 compared to \$168,000 for 1996 with the increase due to the short year in 1996.

## FINANCING COSTS

The financing costs of \$4.3 million in 1997 (\$2.7 million in 1996) consist of the interest expense on the long-term debt of Canadian Oil Sands, standby charges on the \$50 million Revolving Credit Facility and the amortization of deferred financing costs. The average rate of interest in 1997 was 4.2 percent compared to 5.2 percent in 1996. The 1997 interest charges include the \$1.5 million benefit from exchanging the 7.625 percent fixed rate US dollar payments on the Senior Notes for a floating Canadian dollar payment equivalent to Bankers Acceptance plus .5725 of one percent per annum on \$97.1 million.

## INCOME TAXES

Canadian Oil Sands is liable for both the Large Corporations Tax and corporate income taxes. During 1997, Canadian Oil Sands paid \$318,000 in Large Corporation Tax which is assessed on the amount of taxable capital employed by the corporation. The 1996 charge of \$122,000 was lower primarily due to the short taxation year in 1996.

Canadian Oil Sands is not currently taxable as its taxable income is sheltered by payments made pursuant to the Trust Royalty and claiming Capital Cost Allowance sufficient to eliminate taxable income in 1997 and 1996.

The Trust is a Mutual Fund Trust for income tax purposes, and as such, is taxable only to the extent of any taxable income not allocated to Unitholders. The Trust Royalty payment of \$38.5 million in 1997 and \$19.2 million in 1996 paid to the Trust by Canadian Oil Sands are taxable receipts for the Trust. During 1997 and 1996, the Trust has eliminated its taxable income by deducting its administrative expenses, Resource Allowance, the amortization of issue costs and the amortization of the cost of the Trust Royalty. With its taxable receipts fully sheltered, the Trust has been able to designate its distributions in 1997 and 1996 as a return of capital for income tax purposes. With over \$250 million of Trust Royalty costs available to shelter taxable receipts in future years, it is anticipated that the Trust will be able to distribute cash as a return of capital for at least the next four years.

For Canadian income tax purposes, distributions categorized as a return of capital will reduce the Unitholder's Adjusted Cost Base in the Trust Unit. Upon the disposition of a Trust Unit, the unitholder will generally realize a capital gain (or capital loss) for income tax purposes equal to the amount by which the net proceeds are greater (or less) than the Unitholders Adjusted Cost Base in the Trust Unit.

The income tax liability of each Unitholder will depend on the Unitholder's specific circumstances, and accordingly, each Unitholder should obtain independent advice regarding their specific income tax status.

## DISTRIBUTABLE INCOME

Distributable income for the year ended December 31, 1997 totaled \$41.4 million (\$1.80 per unit), including \$3.4 million of surplus cash, compared to \$21.4 million (\$0.93 per unit), including \$2.4 million of surplus cash, for the six months and 11 day period ended December 31, 1996. At the end of 1997, a Reserve for Future Production Costs of \$3.3 million (\$0.14 per unit) had been accrued in respect of future capital expenditures and operating costs.

Distributable Income, as defined in the Trust Indenture, is to be distributed to the Unitholders on the 15th day of the second month following the end of each calendar quarter. The calculation of the Trust Royalty and Distributable Income is as follows:

	Year Ended Dec. 31, 1997		From Formation on June 20, 1996 to Dec. 31, 1996	
	Amount	Per BBL	Amount	Per BBL
(in 000's except per bbl amounts)				
<b>Revenue</b>				
Sale of Syncrude production	\$209,265	\$ 27.77	\$127,981	\$ 30.87
Hedging settlements	252	0.03	(9,634)	(2.32)
Interest earned	979	0.13	301	0.07
	210,496	27.93	118,648	28.62
<b>Expenses</b>				
Operating	103,768	13.77	50,846	12.27
Crown Royalties	20,184	2.68	29,455	7.11
Administration	3,343	0.44	1,491	0.36
Financing costs	4,270	0.57	2,721	0.65
Large Corporations Tax	318	0.04	122	0.03
	131,883	17.50	84,635	20.42
Operating Cash Flow	78,613	10.43	34,013	8.20
Capital Expenditures	(35,358)	(4.69)	(14,178)	(3.42)
Mining Reclamation Trust	(763)	(0.10)	(415)	(0.10)
Site Restoration	(325)	(0.04)	-	-
Reserve - Future Prod. Costs	(3,280)	(0.44)	(44)	-
<b>Base for Trust Royalty</b>	<b>\$ 38,887</b>	<b>\$ 5.16</b>	<b>\$ 19,376</b>	<b>\$ 4.68</b>
<b>Production (in 000's of bbls)</b>	<b>7,536</b>		<b>4,145</b>	
<b>Trust Distributions</b>				
Trust Royalty	\$ 38,498		\$19,182	
Distribution of Surplus Cash	3,353		2,376	
Trust Administration	(451)		(168)	
<b>Distributable Income</b>	<b>\$ 41,400</b>		<b>\$21,390</b>	
<b>Distributable Income per Trust Unit</b>	<b>\$ 1.80</b>		<b>\$ 0.93</b>	

## LIQUIDITY AND CAPITAL RESOURCES

At the end of 1997, the Trust had cash balances of \$19.9 million and unused lines of credit totaling \$250 million as well as long-term debt obligations aggregating to US\$70 million in respect of the 7.625 percent Senior Notes issued in May of 1997. During 1997, the Trust generated \$78.0 million from operations of which \$35.4 million funded capital expenditures and \$41.4 million was distributed to the Trust Unitholders. Except for the amount of credit available, the cash balances and long-term debt positions at the end of 1997 are relatively unchanged from 1996.

On May 20, 1997, Canadian Oil Sands issued US\$70 million principal amount of 7.625 percent Senior Notes using the proceeds to refinance the existing \$95 million Term Bank Loan. The 7.625 percent Senior Notes have less restrictive covenants than the Term Bank Loan and defer all principal repayments to the maturity date of the notes on May 15, 2007.

On November 26, 1997, Canadian Oil Sands increased its lines of credit by \$200 million. This increase brings the lines of credit available to \$250 million, however, they may be reduced at any time by Canadian Oil Sands, if desirable.

On February 19, 1998, the Trust issued 4 million Trust Units to a syndicate of underwriters at a price of \$24.00 per Trust Unit for net proceeds of \$92 million. These funds, along with its \$250 million lines of credit, were raised to fund Canadian Oil Sands' 10 percent share of the "Syncrude 21" expansion.

## RISK MANAGEMENT

Canadian Oil Sands is subject to the operational risks inherent in the oil sands business. As a joint venture partner in the Syncrude Project, it will actively participate in operational risk management programs implemented by Syncrude. Its exposure to operational risks is also managed by maintaining appropriate insurance. To mitigate its exposure to financial risks such as fluctuations in commodity prices, foreign currency exchange rates and interest rates, Canadian Oil Sands has a financial risk management program.

### Insurance Coverage

Canadian Oil Sands maintains \$70 million of physical loss insurance with a \$5 million deductible which will mitigate property damages experienced by the Syncrude Project up to \$750 million. Canadian Oil Sands also maintains \$115 million of business interruption insurance, subject to a 30 day deductible period, to restore earnings lost due to an accidental disruption in Syncrude's operations.

## Currency Hedging

At the time of the initial public offering, Canadian Oil Sands minimized the exposure of its cash flow and its Unitholder distributions to fluctuations in the foreign currency rate risk by implementing a 20 year currency hedge. Approximately 35 percent of Canadian Oil Sands' anticipated cash flow is hedged at an exchange rate of US\$0.6937 per Canadian dollar. In 1997, the currency hedge added \$2.7 million to Canadian Oil Sands revenue as \$12 million of US currency was settled at US\$0.6937 quarterly compared to the average exchange rate for the year of US\$0.7222. These settlements added \$0.12 per unit to the 1997 cash distributions compared to \$0.09 in 1996. To fund the US\$21.00 oil price put options purchased in October of 1997, gains from the sale of approximately US\$44 million of the foreign currency hedge for the years 2012 through 2015 was used leaving the current year's cash flow available for distributions to Unitholders. On February 10, 1998 the mark-to-market value of the currency hedge was \$47 million, or \$1.75 per unit based on 27 million units outstanding.

The mark-to-market value of the currency hedge is determined by, and is primarily dependent on, the Canadian/US currency exchange rate and the differential between the Canadian and US interest rates. If the Canadian dollar strengthens relative to the US dollar, the value of the currency hedge should increase, and if the Canadian dollar weakens, the value of the currency hedge should decrease. If US interest rates rise relative to Canadian interest rates, the value of the currency hedge will increase, and conversely if the Canadian interest rates rise relative to the US interest rates, the value of the currency hedge will decrease. However, changes in the Canadian/US currency exchange rate and interest rates do not generally occur in isolation and the benefits of a strengthening Canadian dollar may offset an increase in Canadian interest rates.

## Oil Price Hedging

In 1996, oil price options were placed which limited 1997's oil prices to a range of US\$16.00 to US\$20.20 per barrel on 8,000 barrels per day during the first quarter and a floor of US\$16.00 per barrel on 8,000 barrels per day for the balance of 1997. The cost of these options totaled \$3.4 million and was accounted for as a price adjustment in 1997.

In early October of 1997, Canadian Oil Sands entered into oil price put options which provided a floor price of US\$21.00 per barrel for 10,000 barrels per day for the fourth quarter of 1997 as well as 7,000 barrels per day for the first quarter of 1998. These options were placed to assure a reasonable fourth quarter distribution as well as fund Syncrude's increasing capital expenditures while retaining

the upside in WTI pricing. The options for the fourth quarter of 1997 were settled with a payment of \$1.6 million (\$2.04 per barrel hedged) received in early 1998 while the current mark-to-market for the first quarter of 1998 options was \$4.0 million on February 10, 1998.

It is management's intention to provide a long-term investment opportunity balanced with a need to maximize the investment's cash yield. Accordingly, oil price hedging may be used from time to time to ensure cash flow is available to meet capital commitments and maintain reasonable levels of distributions.

### Interest Rate Hedging

Subsequent to the issuing of the Senior Notes, Canadian Oil Sands entered into a cross currency interest swap to exchange the US dollar fixed interest payment on the Senior Notes for a floating Canadian dollar payment. This exchange resulted in an effective interest rate of 4.2 percent in 1997 rather than the 7.625 percent attached to the Senior Notes. The cash settlement on November 15, 1997 was \$1.6 million representing the benefit of this swap for the first six months.

### OUTLOOK FOR 1998

Canadian Oil Sands' operating cash flow is sourced entirely from its working interest in the Syncrude Project with the revenues subject to fluctuations in the price of West Texas Intermediate crude oil. Canadian Oil Sands intends to make quarterly distributions to its Unitholders and fund capital expenditures of a sustaining nature from its operating cash flow. As the expansion of Syncrude results in a doubling of production, which for Canadian Oil Sands is the equivalent to acquiring another 10 percent interest in Syncrude, Canadian Oil Sands intends to finance the expansion of Syncrude using some combination of external financing and internally generated cash flow.

### Syncrude Operations

Based on its 1998 budget, Syncrude expects to produce 80 million barrels of SSB with an operating cost of \$13.57 per barrel compared to 75.7 million barrels in 1997 at a cost of \$13.77. Syncrude's capital expenditures are expected to total approximately \$631 million including \$445 million in respect of the "Syncrude 21" projects. The highlights of the 1998 capital spending program are the development of a second train in the North Mine, the commencement of the Aurora Mine construction, increasing the upgrader capacity by adding a vacuum tower and de-bottlenecking existing facilities to handle the increased production from the Aurora and North Mine.

### Cash Distributions to Unitholders

With the expansion of Syncrude using some combination of external financing and internally generated cash flow, Unitholders should anticipate receiving a stable stream of income subject to fluctuations in commodity prices.

### Sensitivity Analysis

Canadian Oil Sands has developed its 1998 budget based on its expectations for crude oil prices, the Canadian/US currency exchange rate, production volumes, operating expenses and capital expenditures. The following outlines the expected change in Distributable Income, after giving effect to the issue of an additional 4 million Trust Units in February of 1998, caused by a change in one of these factors:

	Change in Distributable Income (per unit)
US\$1.00 change in price of West Texas Intermediate crude oil	\$0.37
US\$0.01 change in US/Canadian Currency exchange rate	\$0.07 <sup>(1)</sup>
1 million barrel change in Syncrude's production	\$0.09
\$1.00 change in unit operating cost per barrel	\$0.29
\$10 million change in capital spending	\$0.40

<sup>(1)</sup> The impact of the change in the US/Canadian currency exchange rate has been calculated taking into account the currency hedging activities.

Each of these factors will fluctuate to some degree in 1998 and the resulting net change in Distributable Income will be determined from their combined effect.

### Year 2000

Canadian Oil Sands relies on the Syncrude Project's computer systems to control much of the processing and financial reporting as well as the computer systems of PanCanadian Petroleum Limited for financial reporting and various administrative support functions. Both organizations have begun assessing their computer systems and applications to ensure they are designed to manage the date change in the year 2000. It is our current expectations that the required remediation work, if any, will be completed well before the year 2000.

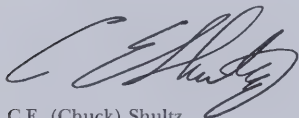
## MANAGEMENT'S REPORT

Management is responsible for all information contained in this annual report. The consolidated financial statements have been prepared in accordance with generally accepted accounting principles, and include amounts based on management's informed judgements and estimates. The financial and operating information included in this annual report is consistent with that contained in the consolidated financial statements in all material respects.

To assist management in fulfilling its responsibilities, systems of accounting and internal controls are maintained to provide reasonable assurance that financial information is reliable and accurate, and that assets are adequately safeguarded.

External auditors, appointed by the Unitholders, have independently examined the consolidated financial statements and conducted a review of accounting and internal controls to the extent required under generally accepted auditing standards. They have performed such tests as they deemed necessary to enable them to express an opinion on these financial statements.

The Board of Directors also serves as the Audit Committee. The Board of Directors meets periodically with the external auditors to discuss controls over the financial reporting. In addition, the Board of Directors recommends the appointment of the external auditors, who are appointed annually by the Unitholders. The Board of Directors has reviewed the financial statements and the contents of this annual report with management and the external auditors. The Board of Directors has approved the consolidated financial statements.



C.E. (Chuck) Shultz  
Chairman of the Board



R.W. Fotheringham  
Chief Financial Officer

February 19, 1998

## AUDITORS' REPORT

To the Unitholders of Canadian Oil Sands Trust

We have audited the consolidated balance sheets of Canadian Oil Sands Trust (the Trust) as at December 31, 1997 and December 31, 1996 and the consolidated statements of income and unitholders' equity and changes in cash position for the periods then ended. These financial statements are the responsibility of the Trust's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Trust as at December 31, 1997 and December 31, 1996 and the results of its operations and changes in its cash position for the periods then ended in accordance with generally accepted accounting principles.



Chartered Accountants

Calgary, Alberta

January 23, 1998

(except note 15 which is as of February 19, 1998)

# CONSOLIDATED BALANCE SHEET

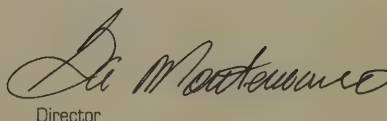
<i>(thousands of dollars)</i>	<b>December 31, 1997</b>	December 31, 1996
<b>ASSETS:</b>		
Current assets:		
Cash	<b>\$ 19,934</b>	\$ 19,124
Restricted cash	<b>1,334</b>	1,461
Accounts receivable	<b>22,254</b>	22,817
Inventories	<b>10,424</b>	8,339
Prepaid expenses	<b>266</b>	4,779
	<b>54,212</b>	56,520
Reclamation trust (note 13)	<b>1,178</b>	415
Capital assets, net of accumulated depletion, depreciation and amortization of \$37,751 in 1997; \$12,610 in 1996	<b>423,559</b>	413,424
Deferred charges	<b>6,029</b>	1,530
	<b>\$ 484,978</b>	\$471,889
<b>LIABILITIES AND UNITHOLDERS' EQUITY:</b>		
Current liabilities:		
Accounts payable and accrued liabilities	<b>\$ 18,561</b>	\$ 27,018
Unit distribution payable	<b>13,800</b>	8,740
	<b>32,361</b>	35,758
Other liabilities (note 4)	<b>14,365</b>	13,636
Long-term debt (note 6)	<b>100,100</b>	95,000
Future site reclamation and restoration costs (note 13)	<b>8,192</b>	7,382
Preferred shares of subsidiary (note 7)	<b>2,000</b>	2,000
	<b>157,018</b>	153,776
Unitholders' equity (notes 8 and 15)	<b>327,960</b>	318,113
	<b>\$ 484,978</b>	\$471,889

Commitments (note 14)

*See accompanying notes*

Approved by the Board

  
Director

  
Director

# CONSOLIDATED STATEMENT OF INCOME AND UNITHOLDERS' EQUITY

	Year Ended December 31, 1997	June 20 to December 31, 1996
<i>(thousands of dollars except per unit amounts)</i>		
<b>REVENUES:</b>		
Syncrude Sweet Blend	\$ 209,525	\$ 118,347
Other	979	310
	<b>210,504</b>	<b>118,657</b>
<b>EXPENSES:</b>		
Operating	103,768	50,846
Administration	3,794	1,659
Crown Royalties (note 11)	20,184	29,455
Interest	4,270	2,721
Depletion, depreciation and amortization	26,703	13,233
Large Corporations Tax	318	122
Dividends on preferred shares of subsidiary (note 7)	220	118
	<b>159,257</b>	<b>98,154</b>
<b>NET INCOME FOR THE PERIOD</b>	<b>51,247</b>	<b>20,503</b>
<b>UNITHOLDERS' EQUITY, BEGINNING OF PERIOD</b>	<b>318,113</b>	—
<b>PROCEEDS ON ISSUE OF 23,000,010 TRUST UNITS</b>	—	319,000
<b>CASH DISTRIBUTIONS TO UNITHOLDERS</b>	<b>(41,400)</b>	<b>(21,390)</b>
<b>UNITHOLDERS' EQUITY, END OF PERIOD</b>	<b>\$ 327,960</b>	<b>\$ 318,113</b>
<b>NET INCOME PER TRUST UNIT</b>	<b>\$ 2.23</b>	<b>\$ 0.89</b>
<b>DISTRIBUTABLE INCOME PER TRUST UNIT</b>	<b>\$ 1.80</b>	<b>\$ 0.93</b>
<i>See accompanying notes</i>		

# CONSOLIDATED STATEMENT OF CHANGES IN CASH POSITION

<i>(thousands of dollars)</i>	Year Ended December 31, 1997	June 20 to December 31, 1996
<b>CASH PROVIDED BY (USED IN):</b>		
<b>OPERATIONS:</b>		
Net income	\$ 51,247	\$ 20,503
Items not involving cash:		
Depletion, depreciation and amortization	26,703	13,233
Other	99	-
Funds from operations	78,049	33,736
Net change in deferred items	(1,067)	2,023
Site restoration costs	(325)	-
Change in non-cash working capital	396	(1,638)
	77,053	34,121
<b>FINANCING:</b>		
Issue of (repayment of) long-term debt	(95,000)	95,000
Issuance of senior notes (note 6)	96,278	-
Distributions to unitholders	(41,400)	(21,390)
Issuance of Trust Units	-	319,000
Issuance of preferred shares	-	2,000
	(40,122)	394,610
<b>INVESTMENTS:</b>		
Acquisition of working interest (note 3)	-	(395,014)
Reclamation trust	(763)	(415)
Capital assets	(35,358)	(14,178)
	(36,121)	(409,607)
<b>INCREASE IN CASH</b>	<b>810</b>	<b>19,124</b>
<b>CASH AT BEGINNING OF PERIOD</b>	<b>19,124</b>	<b>-</b>
<b>CASH AT END OF PERIOD</b>	<b>\$ 19,934</b>	<b>\$ 19,124</b>

See accompanying notes

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(All tabular amounts are in 000's)

### 1. GENERAL

Canadian Oils Sands Trust (the Trust) is a closed-end investment trust formed under the laws of the Province of Alberta pursuant to a Trust Indenture dated April 19, 1996. The Trust commenced operations on June 20, 1996 when a subsidiary of the Trust, Canadian Oil Sands Investments Inc. (Canadian Oil Sands), acquired a 10 percent interest in a joint venture (the Working Interest) involved in the mining and upgrading of bitumen from oil sands in Northern Alberta (the Syncrude Project). The Working Interest acquired by Canadian Oil Sands is subject to a royalty interest held by the Trust equal to 99 percent of the revenues from the sale of the Working Interest's share of production less certain defined costs including capital expenditures and debt repayments incurred by Canadian Oil Sands (the Trust Royalty).

### 2. SUMMARY OF ACCOUNTING POLICIES

#### (a) Consolidation

These consolidated financial statements include the accounts of the Trust and Canadian Oil Sands. The activities of the Syncrude Project are conducted jointly with others, and accordingly, these financial statements reflect only Canadian Oil Sands' proportionate interest in such activities which include the production volumes, operating costs, capital expenditures and associated amounts payable. Substantially, all other activities and balances in these financial statements, including sales, are applicable directly to the Trust or Canadian Oil Sands.

#### (b) Capital Assets

Capital assets are recorded at cost and include the costs of acquiring the Working Interest, the initial issuing costs of the Trust Units and subsequent additions to property, plant and equipment. Repairs and maintenance costs are charged to expense in the period incurred. Proceeds from the sale of plant and equipment are normally deducted from the capital base without recognition of a gain or loss.

Capital costs are amortized on the unit-of-production method based on estimated proven reserves at existing mine sites and permit life of the Syncrude project. For purposes of the depletion provision, capital costs include additional capital costs expected to be necessary in the mining, extraction and upgrading process to recover the estimated proven reserves. Included in capital costs at December 31, 1997 are costs of \$1.5 million (1996 - NIL) related to unproven mine site development that have been excluded from costs subject to depletion as the related reserves have not yet been classified as proven.

Estimated site restoration and reclamation costs are provided for on the unit-of-production method based on estimated proven reserves. Actual costs are charged against the accumulated provision when incurred.

#### (c) Inventories

Inventories of intermediate products of Syncrude Sweet Blend are valued at the lower of the average cost of production for the period and their net realizable value. Materials and supplies inventories are valued at the lower of average cost and replacement cost.

#### (d) Foreign Currency Translation

Transactions in foreign currency are translated into Canadian dollars at the exchange rates prevailing at the transaction date. Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at period end exchange rates. Exchange gains and losses are included in earnings, except for the gains and losses on the Senior Notes which are deferred and amortized over the remaining term of the Senior Notes.

#### (e) Forward Contracts

Canadian Oil Sands enters into foreign exchange and commodity price contracts to hedge the effect of exchange rate and commodity price fluctuations. Gains and losses on forward contracts are deferred and recognized as a component of the related transaction.

#### (f) Revenue

Revenue from the sale of Syncrude Sweet Blend and other products is recorded at the plant gate and is net of a marketing fee paid to PanCanadian Petroleum Limited (see Note 10b).

### 3. ACQUISITION OF THE WORKING INTEREST AND TRUST ROYALTY

On June 20, 1996, the Working Interest and Trust Royalty were acquired by Canadian Oil Sands and the Trust, respectively, and the results of operations have been included in these financial statements from that date using the purchase method of accounting. The following summarizes the acquisition:

Property, plant and equipment,	
including issue costs of \$21.1 million	\$ 413,387
Non-cash working capital	1,039
Non-current liabilities assumed	(18,373)
Total net assets acquired	396,053
Cash at closing	19,947

Total Ascribed Value of Assets Acquired	\$ 416,000
---	------------

Financed by:	
Proceeds on the issue of Trust Units	\$ 319,000
Preferred shares issued by	
Canadian Oil Sands (see Note 7)	2,000
Bank loan	95,000

Total Consideration Paid	\$ 416,000
--------------------------	------------

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(All tabular amounts are in 000's)

### 4. OTHER LIABILITIES

	1997	1996
Liabilities for utility plant and other(a)	\$ 7,047	\$ 4,797
Northward Developments	-	24
Accrued pension benefits in excess of pension assets(b)	7,318	8,815
	\$ 14,365	\$ 13,636

#### (a) Utility Plant and Other

Under the terms of an Energy Sales Agreement covering power purchases from a plant which provides electrical energy and steam to Syncrude, a cost of service fee totaling \$4.8 million is payable to TransAlta in equal monthly installments commencing on April 1, 1999 and continuing until March 31, 2003. The remaining amount represents an obligation under capital leases.

#### (b) Pension Plan

Syncrude Canada Ltd., the operator of the Syncrude joint venture, has a defined benefit pension plan which covers substantially all of its employees. The Plan provides pension benefits upon retirement based on length of service and the highest three years average earnings during the last ten years of service with Syncrude Canada Ltd.

Canadian Oil Sands' 10 percent share of the present value of accrued pension benefits and the market value of the Plan assets available to provide for these benefits is as follows:

	1997	1996
Accrued pension benefits	\$ 53,611	\$ 52,340
Plan assets	\$ 58,413	\$ 51,324

#### (c) Restricted Cash

In connection with the acquisition of the Working Interest, Canadian Oil Sands received funds from PanCanadian Petroleum Limited which were restricted to the payment of certain liabilities, and accordingly, these funds have been classified as Restricted Funds in these financial statements.

### 5. BANK CREDIT FACILITIES

Effective November 26, 1997, Canadian Oil Sands increased its unsecured lines of credit to \$250 million comprised of a \$220 million Revolving Term Credit Facility and a \$30 million Extendible Revolving Facility. The \$30 million Extendible Revolving Facility (\$50 million prior to November 26, 1997) enables working capital needs to be borrowed and repaid and reborrowed for a period of five years. The term of this facility may be extended on an annual basis for a further five year term, subject to the agreement of the bank. Amounts borrowed bear interest at a floating rate based on Bankers' Acceptances plus 0.40 of one percent while any unused

amounts are subject to a 0.12 of one percent per annum standby fee. As at December 31, 1997, there were no amounts drawn under the Extendible Revolving Facility.

The \$220 million Revolving Term Credit Facility provides for funds to be borrowed and repaid and reborrowed for a period of five years after which the amount owing converts to a five year term loan with semi-annual repayments. Amounts borrowed through this facility bear interest at a floating rate based on Bankers' Acceptances plus one half of one percent. The unused amount of the facility will be subject to a one eighth of one percent per annum standby fee. As at December 31, 1997, there were no amounts drawn under the Revolving Term Credit Facility.

These credit agreements contain covenants which restrict Canadian Oil Sands' ability to sell assets or engage in activities other than the ownership of oil sands assets. Canadian Oil Sands has agreed to maintain its debt to capital employed ratio of not greater than 0.45 to 1.0 and not to make distributions to unitholders if its long-term debt is greater than 3.5 times its earnings before interest, taxes, depreciation and amortization, on a four quarter rolling average.

Pursuant to its Articles of Incorporation as amended on June 6, 1996, Canadian Oil Sands shall not incur Indebtedness for Borrowed Money, as defined, which when incurred exceeds 45 percent of its Borrowing Base. The Borrowing Base is defined as an amount equal to \$380 million, as adjusted for acquisitions and divestitures of working interests in the Syncrude Project, plus the unamortized amount of capital expenditures incurred to increase, rather than sustain, production from the Syncrude Project. As at December 31, 1997, the Borrowing Base was \$403 million. The funds available under the Revolving Term Credit Facility are limited to the lesser of the amount of the credit facility and the amount permitted by the Articles of Incorporation.

### 6. SENIOR NOTES

On May 20, 1997, Canadian Oil Sands issued US\$70 million of 7.625 percent Senior Notes due May 15, 2007 (the Senior Notes) for cash proceeds of US\$69.9 million. The Senior Notes are unsecured obligations of Canadian Oil Sands, rank *pari passu* with all other unsecured and unsubordinated indebtedness and restrict Canadian Oil Sands' ability to sell assets.

During 1997, the effective rate of interest on the Senior Notes was 4.2 percent after giving effect to the cross currency interest rate swap described in Note 9.

### 7. PREFERRED SHARES OF CANADIAN OIL SANDS

In connection with the acquisition of the Working Interest, Canadian Oil Sands issued 1,000 preferred shares to PanCanadian Petroleum Limited for aggregate consideration

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(All tabular amounts are in 000's)

of \$2.0 million. The preferred shares entitle the holder to a cumulative annual dividend, payable quarterly, of 11 percent of the issue price of the preferred shares to the end of 1997, and thereafter, a cumulative annual dividend of 15 percent. The preferred shares are retractable at the option of PanCanadian under certain conditions relating to the continuation of the Trust, the disposition of the Trust Royalty, the continuation of the administrative services agreement between PanCanadian and Canadian Oil Sands and upon the non-payment of dividends for a total of five years. The preferred shares also entitle the holder to elect two directors to the Canadian Oil Sands' Board of Directors.

### 8. UNITHOLDERS' EQUITY

A maximum of 500 million Trust Units have been created for issuance pursuant to the Trust Indenture.

The Trust Units represent beneficial interests in the Trust. All Trust Units will share equally in all distributions from the Trust and carry equal voting rights. No conversion, retraction or pre-emptive rights attach to the Trust Units.

As at December 31, 1997 and 1996, there were 23,000,010 Trust Units issued and outstanding. During 1996, there were 10 Trust Units issued for cash consideration of \$100 upon formation of the Trust, 12,900,000 Trust Units issued on the exercise of Special Warrants which had been issued in a private placement for cash consideration of \$13.65 per Special Warrant and 10,100,000 Trust Units issued for cash consideration of \$14.15 per Trust Unit pursuant to the Initial Public Offering Prospectus dated June 5, 1996.

### 9. FINANCIAL INSTRUMENTS

In 1996, Canadian Oil Sands entered into foreign exchange forward contracts fixing the exchange rate at approximately US\$0.6937 on US\$1.5 billion with quarterly cash settlements until June 2016. During 1997, the cash settlements on US\$12 million per quarter aggregated to \$2.7 million which have been recorded as revenues from the sale of Syncrude Sweet Blend in the financial statements. As at December 31, 1997, the mark-to-market value of this currency hedge was \$29.8 million.

During 1997, Canadian Oil Sands entered into oil price put options providing a floor price of US\$21.00 per barrel for 10,000 barrels per day for the fourth quarter of 1997 as well as 7,000 barrels per day for the first quarter of 1998. The cash settlements on the 10,000 barrels per day for the fourth quarter of 1997 aggregated to \$1.6 million which have been recorded as revenues from the sale of Syncrude Sweet Blend in the financial statements. As at December 31, 1997, the mark-to-market value of the 7,000 barrels per day for the first quarter of 1998 was \$3.1 million.

In 1996, Canadian Oil Sands entered into oil price put options and call options providing a pricing collar on 8,000 barrels per day for the first quarter of 1997 which limited prices to a range of US\$16.00 and US\$20.20 per barrel. The call option at US\$20.20 per barrel was bought back in October of 1996 at a cost of \$3.4 million which has been accounted for in 1997 as a price adjustment on the sale of Syncrude Sweet Blend in the financial statements. In addition, Canadian Oil Sands entered in oil price put options providing a floor price of \$16.00 per barrel for 8,000 barrels per day for the last three quarters of 1997 at a cost of \$0.7 million which has also been accounted for in 1997 as a price adjustment on the sale of Syncrude Sweet Blend in the financial statements.

Subsequent to issuing the Senior Notes, Canadian Oil Sands entered into a cross currency interest rate swap to exchange the US dollar 7.625 percent interest payments on the Senior Notes for a floating Canadian dollar interest rate equivalent to Bankers' Acceptances plus .5725 of one percent per annum on \$97.1 million. These agreements require semi-annual cash settlements until the maturity of the Senior Notes on May 15, 2007. In 1997, the cash settlement aggregated to \$1.5 million in favour of Canadian Oil Sands and has been recorded as a reduction to interest expense in the financial statements. As at December 31, 1997, the mark-to-market value of this cross currency interest rate swap was \$11.9 million.

The fair value of financial instruments that are included in the consolidated balance sheet, including long-term borrowings, approximate their recorded amount due to the short-term maturity of the instruments. The use of financial instruments involves a degree of credit risk which Canadian Oil Sands manages through its credit policies and selection of counterparties.

### 10. RELATED PARTY TRANSACTIONS

PanCanadian Petroleum Limited was the initial promoter of the Trust, was the vendor of the Working Interest acquired by Canadian Oil Sands and holds 1,000 preferred shares of Canadian Oil Sands. PanCanadian has entered into the following agreements with Canadian Oil Sands:

(a) An administrative services agreement whereby PanCanadian provides administrative and support services to Canadian Oil Sands for an initial period of seven years and receives a fee equal to 2.75 percent of the revenue from the Working Interest less operating costs and Crown Royalties. For the year ended December 31 1997, PanCanadian received \$2.4 million pursuant to this agreement (\$1.1 million for the period from June 20, 1996 to December 31, 1996).

(All tabular amounts are in 000's)

(b) A marketing agreement whereby PanCanadian markets all production from the Working Interest on behalf of Canadian Oil Sands for an initial period of seven years and receives a fee equal to \$0.05 per barrel. For the year ended December 31, 1997, PanCanadian received \$0.4 million pursuant to this agreement (\$0.2 million for the period from June 20, 1996 to December 31, 1996).

(c) In 1996, PanCanadian received a \$5.0 million structuring fee from Canadian Oil Sands with respect to the purchase of the Working Interest and the formation of the Trust and Canadian Oil Sands.

# 11. CROWN ROYALTY

The Alberta Crown Agreement creates a joint venture (the Alberta Joint Venture) between the Province of Alberta as lessor and the Syncrude participants as lessees. Its purpose is to annually establish, using a deemed net profit concept, the basis on which Syncrude's annual production is to be shared by the lessor and each of the lessees.

Commencing on January 1, 1997, the Alberta Crown Agreement provides that the Province of Alberta shall be entitled to a royalty of 50 percent of the deemed net profit on the first 74 million barrels of annual production less a credit equal to 43 percent of capital expenditures. The deemed net profit is determined by deducting from the deemed gross revenue the aggregate of allowed operating costs, deemed interest expense and amortization of capital costs and any loss carry-forwards. For annual production in excess of 74 million barrels, the Province of Alberta is entitled to a royalty of 25 percent of the deemed net profit after deducting capital expenditures with a minimum payment of one percent of gross revenue. These provisions will be in effect until the earlier of December 31, 2003 or the last day of the month in which the aggregate of Syncrude's capital spending incurred after December 31, 1995 equals \$2.8 billion. Subsequently, the Alberta Crown Agreement will entitle the Province of Alberta to a royalty payment equivalent to a 25 percent of the deemed net profit as defined above after deducting capital expenditures.

# 12. INCOME AND OTHER TAXES

Canadian Oil Sands is subject to both the Large Corporations Tax and corporate income taxes. During 1997, Canadian Oil Sands paid \$0.3 million in Large Corporations Tax (\$0.1 million in 1996). As at December 31, 1997, Canadian Oil Sands had Undepreciated Capital Costs aggregating to \$85.2 million which are deductible on a declining balance basis at an average rate of 25 percent per annum.

As at December 31, 1997, the Trust had Canadian Development Expenditures aggregating to \$255.1 million which are deductible on a declining balance basis at a rate of 30 percent annually. In addition, the Trust has unclaimed costs relating to the issue of Trust Units aggregating \$12.7 million which are deductible on a straight line basis over the next three and one half years.

# 13. FUTURE SITE RECLAMATION AND RESTORATION COSTS

Canadian Oil Sands and each of the other owners of Syncrude are liable for their share of ongoing environmental obligations for the ultimate reclamation of the Syncrude Project upon abandonment.

Canadian Oil Sands has agreed to deposit \$0.10 per barrel, rising to \$0.12 per barrel in 2001 (to be adjusted for inflation) of Syncrude Sweet Blend produced and attributable to the Working Interest to a reclamation trust established for the purpose of funding Canadian Oil Sands' share of environmental and reclamation obligations in connection with Syncrude.

The provision for future site restoration and reclamation costs of \$0.15 per barrel of production aggregating to \$1.1 million in 1997 (\$0.6 million in 1996) has been included in the provision for depletion, depreciation and amortization.

# 14. NATURAL GAS PURCHASE COMMITMENTS

Syncrude has entered into long-term natural gas purchase contracts, which are subject to an annual price adjustment. As at December 31, 1997 and based on current prices, Syncrude is required to pay a minimum of approximately \$62.1 million annually; the Trust's 10 percent share is \$6.2 million. The contracts expire at varying dates until 2003.

# 15. SUBSEQUENT EVENTS

On February 19, 1998, the Trust issued 4 million Trust Units to a syndicate of underwriters at a price of \$24.00 per Trust Unit. The net proceeds of this offering are estimated to be \$92 million.

# STATISTICAL REVIEW

## CANADIAN OIL SANDS

### Statement of Trust Royalty and Distributable Income

(in thousands of dollars)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year Ended Dec. 31, 1997	June 20, 1996 to Sept. 30, 1996	Fourth Quarter	From Formation on June 20, 1996 to Dec. 31, 1996
Revenues and Expenses of Canadian Oil Sands Investments Inc.								
Revenues	\$ 49,005	\$ 42,897	\$ 58,611	\$ 59,983	\$ 210,496	\$ 62,295	\$ 56,353	\$ 118,648
Operating Costs	(23,557)	(30,771)	(25,912)	(23,528)	(103,768)	(27,149)	(23,697)	(50,846)
Crown Royalties	(6,525)	3,929	(8,168)	(9,420)	(20,184)	(15,645)	(13,810)	(29,455)
Administration Expenses	(679)	(695)	(947)	(1,022)	(3,343)	(794)	(697)	(1,491)
Interest Expense	(1,023)	(1,139)	(1,097)	(1,011)	(4,270)	(1,535)	(1,186)	(2,721)
Capital Taxes	(89)	(70)	(77)	(82)	(318)	(62)	(60)	(122)
	17,132	14,151	22,410	24,920	78,613	17,110	16,903	34,013
Capital Expenses	(6,755)	(11,814)	(9,251)	(7,538)	(35,358)	(6,418)	(7,760)	(14,178)
Mining Reclamation Trust	(170)	(158)	(220)	(215)	(763)	(222)	(193)	(415)
Site Restoration Costs	(262)	(14)	—	(49)	(325)	—	—	—
Reserve - future production costs	(1,580)	2,595	(1,205)	(3,090)	(3,280)	—	(44)	(44)
Base for Trust Royalty	\$ 8,365	\$ 4,760	\$ 11,734	\$ 14,028	\$ 38,887	\$ 10,470	\$ 8,906	\$ 19,376
Trust Royalty @ 99%	\$ 8,281	\$ 4,713	\$ 11,616	13,888	\$ 38,498	\$ 10,365	\$ 8,817	\$ 19,182
Distribution of Excess Cash	3,353	—	—	—	3,353	2,376	—	2,376
Administration Expenses of Trust	(134)	(113)	(116)	(88)	(451)	(91)	(77)	(168)
Distributable Income	\$ 11,500	\$ 4,600	\$ 11,500	\$ 13,800	\$ 41,400	\$ 12,650	\$ 8,740	\$ 21,390
Distributable Income per Trust Unit	\$ 0.50	\$ 0.20	\$ 0.50	\$ 0.60	\$ 1.80	\$ 0.55	\$ 0.38	\$ 0.93
Funds From Operations per Trust Unit	\$ 0.71	\$ 0.62	\$ 0.98	\$ 1.08	\$ 3.39	\$ 0.74	\$ 0.73	\$ 1.47
Net Income per Trust Unit	\$ 0.48	\$ 0.38	\$ 0.63	\$ 0.74	\$ 2.23	\$ 0.49	\$ 0.40	\$ 0.89
Capital Expenditures per Trust Unit	\$ 0.29	\$ 0.51	\$ 0.40	\$ 0.33	\$ 1.54	\$ 0.28	\$ 0.34	\$ 0.62

### Operating Statistics

Daily Average Sales (bbls)	18,839	17,143	23,533	23,002	20,647	21,571	20,877	21,259
Average Selling Price (per bbl at plant gate)	\$ 30.12	\$ 27.04	\$ 26.90	\$ 19.94	\$ 27.82	\$ 30.05	\$ 32.41	\$ 30.92

### Unit Trading Activity

Unit Price (\$)	\$ 23.00	\$ 24.45	\$ 28.90	\$ 28.75	\$ 28.90	\$ 18.00	\$ 21.00	\$ 21.00
- High	\$ 23.00	\$ 24.45	\$ 28.90	\$ 28.75	\$ 28.90	\$ 18.00	\$ 21.00	\$ 21.00
- Low	\$ 19.80	\$ 19.90	\$ 23.05	\$ 23.75	\$ 19.80	\$ 14.20	\$ 17.90	\$ 14.20
- Close	\$ 21.45	\$ 24.10	\$ 28.00	\$ 27.00	\$ 27.00	\$ 17.95	\$ 20.50	\$ 20.50
Volume Traded (in 000's)	8,183	4,480	3,243	2,115	18,021	6,607	10,624	17,231

## SYNCRUDE CANADA

	1997	1996	1995	1994	1993	1992	1991	1990
Annual Shipments of Syncrude Sweet Blend Millions of Barrels	75.7	73.5	73.9	69.8	67.0	65.4	60.3	57.1
Unit Operating Cost per Barrel	\$ 13.77	\$ 13.70	\$ 13.69	\$ 14.98	\$ 15.47	\$ 15.39	\$ 16.51	\$ 17.41
Capital Expenditures (in millions of dollars)	\$ 354.9	\$ 213.8	\$ 204.2	\$ 141.5	\$ 87.6	\$ 79.2	\$ 157.5	\$ 139.1
Workforce Productivity (barrels per employee)	21,549	21,343	20,122	18,004	16,101	15,185	13,596	12,560

## C O R P O R A T E I N F O R M A T I O N



### DIRECTORS AND OFFICERS

C. E. (Chuck) Shultz  
*Chairman of the Board*  
CEO of Dauntless Energy Inc.

G. A. Montemurro  
*Director and Chief Executive Officer*

M. M. L. Kwan  
*Director*  
Senior Vice President and  
Chief Financial Officer,  
PanCanadian Petroleum Limited

W. M. Newhouse  
*Director*  
President, Newhouse Resource  
Management Ltd.

J. B. Zaozirny  
*Director*  
Counsel, McCarthy Tétrault

R. W. Fotheringham  
*Chief Financial Officer*

R. A. Shaw  
*Corporate Secretary*  
Partner, McCarthy Tétrault

K.L. Wiwchar  
*Assistant Corporate Secretary*  
Partner, McCarthy Tétrault

### INVESTOR AND ANALYST CONTACT

Additional information, including investor relations inquiries, may be obtained by contacting the Head Office of Canadian Oil Sands Investments Inc. at:  
P.O. Box 2850  
150 - 9th Avenue S.W.  
Calgary, Alberta T2P 2S5  
Telephone: (403) 268-7825  
Fax: (403) 268-7849  
Internet: [www.canadianoilsandstrust.com](http://www.canadianoilsandstrust.com)

### DISTRIBUTIONS

Subject to the approval of the Board of Directors, Unitholders are entitled to receive quarterly Cash Distributions based on the net cash flow generated by the royalty after certain costs and deductions. Quarterly distributions for 1997 were paid on May 15 to Unitholders of record on May 7, August 15 to Unitholders of record on August 7, November 14 to Unitholders of record on November 7 and February 13, 1998 to Unitholders of record on February 6, 1998.

For the 1998 fiscal year, Cash Distributions will be paid on May 15 to Unitholders of record on May 7, August 15 to Unitholders of record on August 7, November 14 to Unitholders of record on November 7 and February 13, 1999 to Unitholders of record on February 6, 1999.

### ANNUAL MEETING

The annual meeting of the Unitholders of the Canadian Oil Sands Trust will be held on Tuesday, April 21, 1998 at 11:00 a.m. in the Turner Valley Room of the Palliser Hotel, 133 - 9th Avenue S.W., Calgary, Alberta.

### REGISTRAR AND TRANSFER AGENT

Montreal Trust Company of Canada  
Vancouver, Calgary, Regina, Toronto, Montreal, Saint John, Charlottetown, and St. John's in Canada. Montreal Trust is also the Trustee of the Trust.

Unitholders' change of address or inquiries regarding Trust Units or distributions should be directed to:

Montreal Trust Company of Canada  
Suite 600, 530 - 8th Avenue S.W.  
Calgary, Alberta, Canada T2P 3S8  
Attention: Stock Transfer  
Shareholder Communications  
Telephone: (403) 267-6555

### LISTING OF TRUST UNITS

At December 31, 1997, Canadian Oil Sands' 23 million Trust Units were held by investors in Canada and internationally. The Trust Units are listed on The Toronto Stock Exchange and trade under the symbol CO.UN.



**CANADIAN OIL SANDS TRUST**

P.O. BOX 2850, 150 - 9TH AVENUE S.W.

CALGARY, ALBERTA T2P 2S5

TELEPHONE: (403) 268-7825 FAX: (403) 268-7849

INTERNET ADDRESS: [www.canadianoilsandstrust.com](http://www.canadianoilsandstrust.com)